Belgian draft law ratifying the MLI: A new paradigm in international tax law

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On February 4th, 2019, the Belgian government released a draft law ratifying the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (the "Convention") and the Explanatory Note, adopted in Paris on 24 November 2016.[1] The draft bill contains four articles, providing for the full application of the Convention and its explanatory Note, as well as the reservations and notifications made by Belgium and the amendments thereto.

The Convention

The so-called Multilateral Instrument ("**MLI**") has been elaborated to implement the Base Erosion and Profit Shifting ("**BEPS**") measures into tax treaties. The BEPS Action Plan was developed by the Organization for Economic Co-operation and Development ("**OECD**") and G20 to address tax loopholes and mismatches in tax legislations that allow profit shifting for tax evasion.

The MLI, inspired by Action 15 of the BEPS Action Plan, amends existing bilateral tax treaties instead of modifying each such treaty individually. According to the Explanatory Note to the MLI, "*the Convention operates to modify tax treaties between two or more Parties to the Convention. It will not function in the same way as an amending protocol to a single existing treaty, which would directly amend the text of the Covered Tax Agreement; instead, it will be applied alongside existing tax treaties, modifying their application in order to implement the BEPS measures*. (…) *It is possible for Contracting Jurisdictions to agree subsequently to different modifications to their Covered Tax Agreement than those foreseen in the Convention*." As a consequence, the double tax treaties are not modified *per se* by the Convention but it will modify their application.

The Convention aims at enabling contracting jurisdictions to meet the treaty-related minimum standards, i.e. the minimum standard for the prevention of treaty abuse (Action 6) and the minimum standard for improvement of dispute resolution (Action 14) while providing sufficient flexibility to accommodate the diversity of contracting jurisdictions. The following mechanisms encourage said flexible approach:

- allowing the parties to the Convention to specify the existing double tax treaties to which the Convention will apply;

[1] Doc. Parl., Chambre, 2018-2019, n°54-3510/001, https://www.lachambre.be/flwb/pdf/54/3510/54K3510001.pdf.

- allowing the parties to choose between ways of meeting the minimum standards, where alternative ways exist;
- allowing the parties to opt out of the provisions that do not reflect minimum standards through reservations, ruling out the application of these provisions as between the reserving party and all other parties;
- allowing the parties to reserve the right to opt out of applying certain provisions to a subset of covered double tax treaties; and
- allowing the parties to choose to apply optional and alternative provisions.

The regime that will be applicable to the double tax treaties signed by Belgium will depend on the final text of the ratifying law and on the reservations and options made by the other contracting jurisdictions. Indeed, in any cross-border scenario, only those changes to the covered double tax treaty that are accepted by both contracting jurisdictions will be applicable.

The changes brought by the Convention, and soon to be implemented in the application of the covered double tax treaties, amount to an actual change of paradigm, not only due to the unprecedented multilateral amendment approach, but also to the extent it introduces a Principal Purpose Test ("**PPT**") in order to meet the minimum standard of prevention of treaty abuse. Under that new rule, the benefits of a tax treaty will be denied any time obtaining these benefits is one of the main purposes of the arrangements, unless it is proven that granting these benefits would conform to the purpose and object of the treaty provision providing the benefits. That anti-abuse rule is expected to effectively prevent treaty shopping and should have a significant impact on the actual application of international tax law.

The Belgian Position

The draft bill released by the Belgian government reflects a position that differs slightly from the reservations and notifications communicated to the Secretary-General of the OECD (the "**Depositary**") at signature.

Scope of the Convention and Interpretation of the Terms (Articles 1 and 2)

The Convention amends all bilateral tax treaties in force between two parties that have been notified by each such party to the Depositary as an agreement to be covered by the Convention ("Covered Tax Agreements" or "**CTAs**").

Belgium has elected to notify all the tax treaties signed or in force except for:

(i) the new treaty signed on 12 October 2016 with Japan, which already contains the minimum standards plus a series of other measures adopted in the Final BEPS Package; and

(ii) the treaties in force with Germany, Norway and Switzerland, for which the Belgian government gives preference to bilateral negotiations.

At signature, Belgium had notified 98 tax treaties, 56 of which had also been notified by the other parties. These notifications will be modified to add the treaty signed with Botswana on 30 January 2017, the Protocol signed with Russia on 30 January 2018, and the treaty in force with the Netherlands. The notifications will also be modified to reflect that a series of treaties and protocols have entered into force since the signature. The agreement between the Belgian Office, Taipei, and the Taipei Representative Office in Belgium has been withdrawn from the list as it is not a proper international agreement and cannot constitute a CTA in the sense of the Convention.

Hybrid mismatches (articles 3 to 5)

Articles 3 to 5 of the Convention aim at overcoming hybrid mismatches relating to transparent entities (article 3), dual resident entities (article 4) and methods for the elimination of double taxation (article 5). Parties may opt out of the provisions that do not reflect minimum standards.

Transparent entities

Article 3 neutralizes hybrid mismatches resulting from fiscal transparency by ruling out the benefit of double tax treaties where none of the contracting jurisdictions considers the income of such an entity as being attributable to one of its residents.

Belgium has made no reservation with regard to article 3. That provision shall be applicable to the CTAs, to the extent that the other contracting jurisdiction will have accepted to apply the provision as well. Twenty double tax treaties should be affected.

Dual Resident Entities

Where an entity is a resident of more than one party, the competent authorities of the contracting jurisdictions shall endeavor to reach a mutual agreement determining the jurisdiction of which the entity shall be considered a resident. Failing such agreement, the benefit of double tax treaties shall not be granted, unless otherwise decided by competent authorities.

The Belgian government has made a reservation against that provision, considering that it covers both abusive and non-abusive arrangements, and is therefore too broad. The Belgian government considers such a clause to be acceptable as part of bilateral negotiations but not in a multilateral instrument.

Method of elimination of double taxation

Article 5 provides for three options (A, B and C) to remedy difficulties in applying the exemption method where the income is not taxed in the source state. Contracting parties are allowed to choose between one of the three options or may choose to apply none of them. The option elected by a party will be applicable to the residents of that jurisdiction unless the other contracting jurisdiction reserves its right not to apply that article or to refuse the application of Option C (the replacement of the exemption method by the credit method) by the other parties.

Belgium has chosen none of the options and has made no reservation on that provision.

Treaty Abuse (articles 6 to 11)

Part III of the Convention addresses treaty abuse, reflecting BEPS Action 6 and inserting provisions with respect to the minimum standard for the prevention of treaty abuse (articles 6 and 7).

Purpose of a Covered Tax Agreement

According to the first paragraph of article 6, all CTAs shall be modified to include the following preamble text:

> *"Intending to eliminate double taxation with respect to the taxes covered by this agreement without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this agreement for the indirect benefit of residents of third jurisdictions)".*

That paragraph being an element of the minimum standard, a party may only make a reservation to the extent that its CTAs already contain a preamble clause expressing the intention of the parties to eliminate double taxation without creating opportunities for non-taxation.

Article 6, paragraph 3, which is not an element of the minimum standard, allows parties to include the following preamble text in CTAs that do not contain preamble clauses referring to the wish of developing an economic relationship or of enhancing co-operation in tax matters:

> *"Desiring to further develop their economic relationship and to enhance their co-operation in tax matters".*

Belgium has made no reservation relating to the first paragraph. Hence, that passage shall be included in every CTA. Belgium opted to introduce the third paragraph, considering that it is important to clarify the purposes of the treaties in their preambles.

Prevention of Treaty Abuse: the Principal Purpose Test

According to article 7:

> *"Notwithstanding any provisions of a [CTA], a benefit under [CTA] shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the [CTA]."*

Paragraph 15 allows reservation of the right for paragraph 1 not to apply if:

(i) the party "*either rules to address conduit financing structures or a principal purpose test, thereby meeting the minimum standard for preventing treaty abuse under the OECD/G20 BEPS package in such cases, the Contracting Jurisdictions shall endeavour to reach a mutually satisfactory solution which meets the minimum standard;*"

(ii) the Covered Tax Agreements "*already contain provisions that deny all of the benefits that would otherwise be provided under the Covered Tax Agreement where the principal purpose or one of the principal purposes of any arrangement or transaction, or of any person concerned with an arrangement or transaction, was to obtain those benefits*".

In addition, paragraphs 3 and 4 allow the contracting jurisdictions to insert in their CTAs a provision according to which, where a benefit under a CTA is denied to a person pursuant to the PPT, the competent authorities of the contracting jurisdiction may still grant this benefit, if it is established that it would have been granted to that person in the absence of the arrangements.

Paragraph 6 permits parties to choose to apply complementary Simplified Limitations to Profit Provisions in accordance with paragraphs 8 to 13, restricting most conventional benefits under a number of objective conditions.

Belgium has chosen to apply only the PPT, excluding the Simplified Limitations to Profit Provisions. It has also opted for the application of the fourth paragraph. According to the notifications communicated at signature, that clause should be applicable to approximately twenty treaties.

Dividend transfer transaction

Article 8 aims at preventing abuse with respect to dividend withholding tax exemption or limitation in providing for a 365-day minimum holding period.

Parties are allowed to reserve the right for that provision not to apply to its CTAs. Belgium has not made such reservation and a holding period is already required in the double tax treaties entered into by Belgium in recent decades. Article 8 will enable Belgium to add that minimum holding period to older CTAs that do not contain such a requirement. However, thirty-three contracting jurisdictions have already reserved their right not to apply that provision. As is, article 8 should modify approximately fifteen CTAs.

Capital gains from the alienation of shares or interests in real-estate companies

According to article 13, paragraph 4 of the OECD Model, any capital gain derived by a resident from the alienation of shares in an entity that derives more than 50% of its value from immovable property located in a contracting jurisdiction, is taxable in that jurisdiction. Article 9 of the Convention extends the scope of that provision to include interests in partnerships or trusts (first paragraph, indent b). Also, a reference period is included to counter abuses: the relevant value threshold must be met at any time during the 365 days preceding the alienation (first paragraph, indent a). Paragraph 4 also allows parties to insert a specific rule regarding entities principally deriving their value from immovable properties in CTAs that do not currently contain such provision.

As of 2005, Belgium reserved its right not to apply article 13, paragraph 4 of the OECD Model, which is therefore not included in standard treaties or is subject to limitations. Belgium has not opted to include the fourth paragraph and has made a reservation against indent a) of the first paragraph. The government has however not reserved its right not to apply indent b) of the first paragraph, i.e. the extension to partnership and trust. Such extension should be applicable to a dozen CTAs.

Anti-abuse rules relating to permanent establishments located in third jurisdictions

Article 10 addresses situations where:

(i) the enterprise in a contracting jurisdiction derives income from another contracting jurisdiction and the first-mentioned contracting jurisdiction considers that income as being attributable to a permanent establishment located in another jurisdiction; and

(ii) that profit is tax-exempt in the first-mentioned contracting jurisdiction.

In those situations, if the tax levied in the third jurisdiction amounts to less than 60% of the tax that would have been imposed in the first-mentioned contracting jurisdiction if the permanent establishment had been located there, the benefits of the treaty shall not apply, except in a series of cases.

Belgium made a reservation against that provision, as did most of the contracting parties.

Application of Tax Agreements to restrict a party's right to tax its own residents

Article 11 provides that a CTA shall not restrict the right of a contracting jurisdiction to tax its own residents, except with respect to a series of benefits under the CTA.

The Belgian government has made no reservation to that provision.

Avoidance of permanent establishment status

Part IV of the Convention contains four articles modifying the existing tax treaties, in order to deal with the artificial avoidance of permanent establishment status through: commissionaire arrangements and similar strategies (article 12); specific activities exemptions (article 13); and the splitting-up of contracts (article 14). Article 15 defines "a person closely related to an enterprise".

Artificial avoidance of permanent establishment status through commissionaire arrangements and similar strategies

Under article 12, the circumstances in which a person carrying out activities for a contracting party in the name of an enterprise constitutes a permanent establishment of that enterprise, are extended to the person who "*habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise*". That covers not only contracts entered into in the name of the enterprise but also contracts "*for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use or* [contracts] *for the provision of services by that enterprise*".

Finally, where "*a person acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related, that person shall not be considered to be an independent agent*".

At the time of signature, Belgium had made a reservation against that provision. The government has decided to withdraw that reservation, and the extension of the definition of "personal permanent establishment" shall be inserted in CTAs for hich no reservation has been made by the other party (approximately twenty-five CTAs).

Artificial avoidance of permanent establishment status through the specific activity exemptions

According to article 13, a fixed place of business does not constitute a permanent establishment where it is only used to operate a series of listed activities. Parties may choose between two alternative options or may choose to apply none of them. Option A provides that the exception only applies to listed activities that are of a preparatory or auxiliary character. Option B maintains the exceptions provided under CTAs.

Paragraph 4 allows parties to insert an anti-fragmentation rule, preventing an enterprise from splitting its activities among several fixed places of business in order to avoid having a permanent establishment.

Belgium has chosen Option B, which should apply to less than ten treaties, and decided not to make any reservation against the fourth paragraph, which should be inserted in approximately thirty CTAs.

Splitting-up of contracts

Article 14 aims at introducing a provision against abuse consisting in splitting up contracts to artificially avoid exceeding the threshold of 12 months, under which a construction project is not considered to be a permanent establishment.

Belgium has made a reservation against that provision, considering that the PPT and the existing domestic anti-abuse provisions were sufficient to cover the targeted abuse.

Improving dispute resolution

Mutual Agreement Procedure

Article 16 includes the obligation for parties to allow a person to present their case to the competent authorities of either contracting jurisdiction (and not only to the state of residence) within three years from the first notification of the action resulting in taxation. Contracting jurisdictions may make a reservation against that provision provided that the person is allowed to present the case to the competent authorities of their residence state, and that such authorities will implement a bilateral notification or consultation process with the competent authority of the other party.

Where the objection appears to be justified, and if the competent authorities are not themselves able to implement a satisfactory solution, it shall endeavor to resolve the case by mutual agreement with the competent authorities of the other party. The agreements reached shall be implemented regardless of the time limits provided under domestic law of the contracting jurisdictions.

The competent authorities of contracting jurisdictions endeavor to resolve, by mutual agreement, any difficulties or doubts arising from the interpretation or application of the CTA. Competent authorities may also consult one another to resolve double taxation issues that are not covered by the CTA.

Belgium has made no reservation to that provision. The implementation of that minimum standard is being monitored by peers in two phases. The first has closed, and the report on Belgium concludes that the conventions generally conform to the minimum standards except for the time limits.[2] The Convention will enable Belgium to observe that requirement.

Corresponding adjustments

According to article 17, where a contracting jurisdiction operates an adjustment of profits of an enterprise in accordance with the “at arm’s length principle” and taxes the profits of the related enterprise of the other contracting jurisdiction that have been taxed in that jurisdiction, the latter jurisdiction shall operate a corresponding adjustment amounting to the tax imposed on those profits.

Parties are allowed to reserve their right not to apply that provision but Belgium has not used that right. That provision should be included in around half of the existing CTAs.

Arbitration

Part VI contains provisions relating to the choice to apply arbitration (article 18), arbitration proceedings (article 19), the default rules on the appointment of arbitrators (article 20), on the type of arbitration (article 23) and on sharing of the costs (article 25), as well as provisions relating to the confidentiality of proceedings (article 21), the resolution of a case before the arbitration decision (article 22) and the agreement on a different resolution (article 24).

Choice to apply arbitration

According to article 18, parties have the choice whether to apply arbitration or not. Belgium has decided to apply arbitration, which shall be applicable with eighteen other contracting jurisdictions.

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[2] http://www.oecd.org/fr/ctp/resolution/making-dispute-resolution-more-effective-map-peer-review-report-belgium-stage-1-9789264282599-en.htm

Mandatory binding arbitration

Article 19 contains the arbitration clause, pursuant to which, where cases presented for mutual agreement are unresolved within a two-year period, or a three-year period upon the decision of a contracting jurisdiction, they shall be submitted to arbitration. That period may be suspended or extended under a series of circumstances. Pursuant to article 26, parties may reserve their right to limit the scope of application of arbitration, subject to the agreement of the other party.

The arbitration decision shall be implemented through a mutual agreement and shall be final and binding on contracting jurisdictions, except in three listed cases. The contracting jurisdiction may reserve the right to exclude arbitration for issues already settled by a court or administrative tribunal of either jurisdiction, or to provide that an arbitration procedure shall be terminated where a decision is rendered by a court or administrative tribunal.

Belgium has not extended the two-year period to three years but a number of other contracting jurisdictions have, and the extended period should therefore apply to the CTAs concerned. It has made no reservation limiting the scope of application of arbitration, but a number of other contracting jurisdictions have. Belgium may object to these reservations, ruling out the application of arbitration with these parties, but does not intend to do so. It has however reserved its right to maintain existing arbitration clauses. Additionally, Belgium has made a reservation against arbitration where a decision of a court or administrative tribunal has been rendered on the issue.

Type of arbitration

Parties may choose between two default arbitration types:

(i) the "final offer" arbitration process, where the arbitration panel selects one of the resolutions proposed by the competent authorities; or

(ii) the "independent opinion" approach, where the arbitration panel renders a motivated decision, independent from the position of the competent authorities.

The final offer approach is applicable by default. A party may opt for the independent opinion process, except for CTAs for which the parties have refused that approach. In that case, arbitration is not applicable to the CTAs, as long as the authorities have not reached an agreement on the arbitration type. The Convention also allows parties to impose a confidentiality obligation on the taxpayer and permits parties to make a reservation against such choice made by another contracting jurisdiction.

Belgium has selected the final offer arbitration process and has made no reservation against the independent opinion approach in order to insure the applicability of arbitration with parties that have chosen the latter option. It has chosen neither to apply the confidentiality obligation nor to make a reservation against it.

Agreement on a different resolution

The competent authorities are authorised not to apply the arbitration decision if they reach another solution. Belgium has chosen to apply that provision to CTAs for which the other party has selected the independent opinion approach.

Entry into force and into effect

Pursuant to article 34 of the Convention, it has entered into force on 1 July 2018 for the first five signatories, and will enter into force for other ratifying parties (including Belgium) on the first day of the month following the expiration of a three-month period beginning on the date of deposit of the instrument of ratification.

The date of entry into effect of the Convention depends on the tax concerned or on the part of the Convention, and on the date the Convention will enter into force in each of the jurisdictions concerned.

According to article 35,

> *"The provisions of this Convention shall have effect in each Contracting Jurisdiction with respect to a* [CTA]:

a) *with respect to taxes withheld at source on amounts paid or credited to non-residents, where the event giving rise to such taxes occurs on or after the first day of the next calendar year that begins on or after the latest of the dates on which this Convention enters into force for each of the Contracting Jurisdictions to the* [CTA]*; and*

b) *with respect to all other taxes levied by that Contracting Jurisdiction, for taxes levied with respect to taxable periods beginning on or after the expiration of a period of six calendar months (or a shorter period, if all Contracting Jurisdictions notify the Depositary that they intend to apply such shorter period) from the latest of the dates on which this Convention enters into force for each of the Contracting Jurisdictions to the* [CTA]*."*

A party may unilaterally choose to substitute "taxable period" for "calendar year" and to ensure that the entry into effect with respect to other taxes will not take place before the beginning of a calendar year. Belgium has not used these possibilities.

The Mutual Agreement Procedure "*shall have effect with respect to a* [CTA] *for a case presented to the competent authority of a Contracting Jurisdiction on or after the latest of the dates on which this Convention enters into force for each of the Contracting Jurisdictions to the* [CTA], *except for cases that were not eligible to be presented as of that date under the* [CTA] *prior to its modification by the Convention, without regard to the taxable period to which the case relates*". A party may reserve its right not to apply that specific rule, which around twenty contracting jurisdictions to CTAs have done.

A specific rule is also applicable to new CTAs.

A party may reserve its right to postpone the entry into effect of the provisions of the Convention until it has completed its required internal procedures. That reservation is symmetrical, applying to both contracting jurisdictions, if one makes a reservation. It should apply to a dozen CTAs.

According to article 36, arbitration shall have effect:

> *"a) with respect to cases presented to the competent authority of a Contracting Jurisdiction, on or after the later of the dates on which this Convention enters into force for each of the Contracting Jurisdictions to the* [CTA]; *and*
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> *b) with respect to cases presented to the competent authority of a Contracting Jurisdiction prior to the later of the dates on which this Convention enters into force for each of the Contracting Jurisdictions to the* [CTA]*, on the date when both Contracting Jurisdictions have notified the Depositary that they have reached mutual agreement".*

Parties may reserve their right to apply arbitration to a pending case only to the extent that both competent authorities agree that a specific issue may be submitted to arbitration. Belgium did not use that right.

Once the ratifying law is enacted, the Convention will significantly amend the application of the CTAs as from the dates described above, a change of paradigm that will impact the practice of a wide range of professionals.

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